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UNCLAS SECTION 01 OF 03 BRASILIA 000043

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SENSITIVE

TREASURY FOR OASIA - FPARODI

E.O. 12958: N/A

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SUBJECT: LULA AND BRAZILIAN CONGRESS HAVE A FULL PLATE FOR 2005

REF: A. 04 BRASILIA 3048

[B](#). BRASILIA 24
[C](#). 04 BRASILIA 3115
[D](#). 04 BRASILIA 2605
[E](#). 04 BRASILIA 3031
[F](#). 04 BRASILIA 3075
[G](#). 04 BRASILIA 1971
[H](#). 04 BRASILIA 3105
[I](#). 04 BRASILIA 2774

[1](#). (SBU) SUMMARY. By staying in session through Christmas, the Brazilian Congress finally passed the 2005 budget and went into recess until February. The budget process has become dysfunctional and this year's experience may have generated enough frustration to reform it before the next cycle. Overall, Congress had a subpar 2004, although an end-of-year bustle saw a few important bills (Judicial Reform, a Bankruptcy Law, and Public-Private Partnerships) pass into law. Several other key bills were left hanging fire including biotechnology, regulatory agencies, and the final pieces of the 2003 tax and pension reforms. President Lula is likely to shuffle his cabinet in January, reflecting changes in the governing coalition and its dynamic in Congress. When Congress returns to work, it will select a new slate of leaders in both houses and all the committees. So, like last year, 2005 will begin with an overflowing policy agenda. The question is whether, like last year, 2005 will end with that agenda largely unrealized. END SUMMARY.

BUDGET BILL MARKS END OF SESSION

[2](#). (SBU) On December 29, after several brutal weeks of negotiations and two weeks after the scheduled adjournment date, the Brazilian Congress passed the 2005 budget and went into recess until February 15. The procedure was so trying that it sparked calls for a reform of the whole budget process before next year's cycle. Post will report septel on the fiscal implications, but politically the budget process is increasingly dysfunctional and divorced from the realities of GoB revenues and expenditures. The problems are manifold: hundreds of pork amendments, secret side deals, and Members resorting to extortion to force through amendments by threatening quorum calls in the half-empty holiday-period of Congress. In the end, in order to keep the ledgers balanced while accommodating big-ticket administration items such as a minimum wage increase and huge transfer payments to the states, Congressional numbers' crunchers made unrealistically rosy assumptions about next year's growth and revenue figures. Since the Congressional budget bill only authorizes --but does not mandate-- GoB expenditures, President Lula is likely to do what he has done in the past: spend far less than Congress authorized.

BUSY DECEMBER

[3](#). (SBU) Congress had a subpar 2004, failing to make much progress on key bills and wasting inordinate time in partisan fighting before leaving Brasilia in mid-year to stump for candidates in the October municipal elections (ref A). Not until December did key bills finally pass into law:

- On December 2, the new Innovation Law came into force, creating a new agency to stimulate industrial and scientific research (septel).

- On December 8, Congress approved a Constitutional Amendment of important judicial reforms (ref B) that streamlines the overburdened Supreme Court, strengthens human rights protections, and introduces structural reforms and oversight to the courts.

- On December 14, after 11 years in committee, the Bankruptcy Law passed. It should bring greater predictability to creditors and investors, improve the likelihood that failing companies can be restructured, and strengthen the position of banks on the list of creditors (ref C).

- On December 22, Congress approved Public-Private Partnerships, designed to fund large infrastructure projects with a combination of government and private money (ref D).

The bill is close to the heart of President Lula, who believes it will promote his development agenda for the coming years. The administration has drawn up a list of 23 priority projects --mostly roads, railroads and ports.

2005 CONGRESS WILL HAVE A NEW LOOK

14. (SBU) In December, two parties in President Lula's coalition, the PMDB and PPS, fractured between pro-government and opposition factions (refs E,F). These events are still playing out and will be affected by Lula's cabinet shuffle, projected for late-January. Lula is likely to woo large wings of these parties to remain in his camp, and to secure their loyalty with cabinet slots and other favors. His decisions will then be reflected in the new Congressional lineup. In February, Congress will select new leaders in both houses and in all committees. The new Senate President is likely to be Sen. Renan Calheiros (PMDB), a Lula ally, while the front-runner for Chamber President is Dep. Luiz Eduardo Greenhalgh (of Lula's PT). The situation is too fluid to submit to firm predictions, but the early math suggests that the administration will be able to put together narrow majorities in both houses on most votes.

FULL LEGISLATIVE PLATE FOR 2005

15. (SBU) The new Congressional leaders will face a dozen key bills when they open the new session on February 15, many of which are at the heart of the administration's agenda. Unlike 2004, this year will not have any national elections to empty Congress for months on end, but it will see increased partisan jockeying in advance of the 2006 national elections. Last month's defections by the PMDB and PPS were but a prelude to these maneuvers. High on the 2005 legislative agenda are:

- Final pieces of the 2003 tax reform. The most important is unification of the state ICMS tax rates to put an end to the states' fiscal wars in search of investments. If this passes in 2005, the administration may push for a VAT in coming years to unify the federal IPI, the municipal ISS and the state ICMS taxes.

- Final piece of the pension reforms. Not necessarily an administration priority, but it was part of the deal that resulted in the passage of the 2003 public sector pension reforms. Now awaiting a Chamber floor vote.

- Biosafety law. A bill to regulate biotechnology crops and stem cell research has been in Congress for over a year (ref G). The latest iteration, more pro-biotech than previous versions, is now awaiting a final vote in the Chamber and could pass in early 2005.

- Further judicial reforms. The Constitutional Amendment that passed in December 2004 was only the first of three judicial reform packages, with two more slated for 2005 (ref B).

- Regulatory agencies. A bill long awaited by investors to establish operating rules for agencies regulating telecommunications, energy, petroleum, transportation, and water.

- Central Bank autonomy. In May 2003, in the first legislative win of Lula's administration, Congress passed Constitutional Amendment 40 that set the stage for a more autonomous Central Bank. Now Finance Minister Palocci is pushing for the necessary follow-on legislation that would give Central Bank Directors fixed terms in office and formalize what is currently only de facto independence on interest rates.

- Political reform. Lula has said that strengthening the electoral process and political parties is a priority (ref H), so he may push bills that are now in committee dealing with coalitions, campaign financing, and party registration.

- Union and labor reforms, to modernize Brazil's rigid and obsolete laws. The administration had hoped to start reforming the rules governing union activities, and then take on the tougher and broader labor laws. Of the major reforms, these are the least likely to pass in 2005.

- Abortion. The Supreme Court is considering a case that would create just the third exception to the abortion ban (allowing abortions in cases of fetal anencephaly, ref I). The existing two exceptions are cases of rape and danger to the life of the mother. But there are now calls for Congress to assertively legislate the issue rather than leave it to the courts.

- Budget process. As noted above, a reform of the unwieldy budget process has now become a possibility. Although no bill has been drafted, a bicameral working group is expected to start work in February to fast-track this reform.

COMMENT - 2005 OR BUST

16. (SBU) As in the U.S., Brazil's political system is most likely to yield legislative results in odd-numbered years because they provide some insulation from election campaigns.

In 2003 Lula passed significant reforms, but 2004 was dead time in Congress until after the October elections. With a new cabinet and new congressional leadership in place by mid-February, Congress will open its 2005 session as well-positioned as ever to make progress on the raft of bills awaiting its attention. When the 2005 session ends, all eyes will turn to the October 2006 (presidential, congressional, and gubernatorial) elections, meaning that partisan jockeying will make it difficult to pass any tough bills in 2006. 2005 is a now-or-never year for Lula's first-term agenda.

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